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Congress of the United States
House of Representatives

Rep. Darin LaHood
Questions for the Record
Ways and Means Committee
Full Committee hearing – Understanding the Tax Gap and Taxpayer Noncompliance
Thursday, May 9, 2019

Questions for The Honorable J. Russell George:

1. Your recent report on tip-related compliance says that more tips go unreported than are reported. Specifically, out of the $44 billion in estimated tip income for 2006, $23 billion (52%) went unreported. It's clear from the TIGTA Report that there is much room for improvement in closing the tax gap as it relates to tips.

    a. The TIGTA report states that more tip income goes unreported each year than gets reported. You recommend that IRS more effectively prioritize its resources to higher risk work. Do you have any recommendations besides prioritizing workload that would enhance voluntary compliance in this area?

    b. Since the IRS's enforcement reach in this area is limited, to what extent should we consider innovative ideas and incentives to voluntarily encourage better tip reporting?

2. For example, can you confirm your report's finding that the use of tip agreements has achieved higher compliance than would be achieved under regular examinations? Doesn't this fact suggest the need to expand on this concept to more employers?

    a. A key fear of small business salon owners with tipped employees is that the IRS will show up one day and assess them for underreported tips by their employees. Your report indicates the average assessment exceeds $55,000 for small businesses. An assessment of this magnitude would put many small employers out of business. Most salons have 10 or fewer employees.

        i. H.R. 1349 would build on the tip reporting model by providing a safe harbor to employers in the salon industry who opt in to a system that contains the essential elements of a tip agreement (education and reporting obligations) in exchange for an assurance that they won't become subject to a future employer-only audit. To what extent would this improve compliance?

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ii. The TIGTA report indicates that of the 65,000 TRAC agreements in effect in 2017, the IRS completed only 53 reviews since 2013. The IRS has neither the resources to negotiate agreements nor examine them. Why not provide audit protection to salon owners who are willing to comply with the IRS-designed requirements of TRAC?

iii. For employers with TRAC agreements who underreport tip income, the IRS must first complete a compliance review and then go through a process to revoke the agreement. The TIGTA report states that IRS's policy for revocation makes it difficult to revoke. The H.R. 1349 safe harbor proposal should make it easier for IRS to administer – a salon employer who fails to satisfy the basic education and reporting requirements would not be entitled to the safe harbor. To what extent would an opt-in approach for employers mitigate risks, reduce costs and improve compliance?

b. What are the benefits to employees of having their tip income accurately reported? Are assessed amounts collected from an employer in an audit for underreported tip income allocated to the employees for purposes of calculating future SSA benefits?

c. Is it true that, if tip-reporting can be improved by just 10 percent, more than $23 billion would be collected over ten years? Would an incremental improvement in addressing tip reporting noncompliance yield significant revenue?

i. To what extent do you agree that tip reporting remains a difficult challenge?

ii. While full compliance may be unobtainable, can ideas – such as those contained in H.R. 1349 – help improve compliance?

iii. TIGTA has looked into tip-related tax noncompliance and produced a report on this topic. Based on your review, what would be needed to improve voluntary compliance by ten percent?

3. The TIGTA report concludes that there is a higher risk of tax noncompliance for employers in tipping industries that do not have a tip agreement. However, the TIGTA report also acknowledges that the IRS has limited revenue agent resources to manage tip agreements and the number of personnel is not commensurate with the size of the program.

a. The TIGTA report recommends that the IRS prioritize unreported tips with a high dollar value. Why does the TIGTA report solely focus on enforcement?

b. Tip agreements require employers to meet certain obligations in exchange for IRS's assurance that no tip audits will be initiated. Despite the number of agreements in effect, TIGTA concludes that the IRS seldom reviews employers for compliance. The beauty industry is largely comprised of tens of thousands of small businesses with fewer than ten employees. To what extent would it benefit everyone to allow these employers to satisfy the obligations set out in these IRS agreements in exchange for the same audit assurances?

4. IRS research indicates that substantial information reporting results in 93% likelihood of accurate reporting of such income. However, if there is no information reporting (and no withholding), the likelihood of income being accurately reported drops dramatically to 37 percent. To what extent is it more likely that a landlord (who is in the business of renting space) will be more likely to file information reports regarding such rental payments than the multiple freelance individuals operating separate small businesses in the landlord's establishment?

5. One area of concern in the salon industry is when trained employees, who are subject to withholding, move to work as freelance stylists in non-employer salon establishments where they are required to file estimated tax returns on their small business income as well as information reports regarding rental payments made to their landlords. Do you have any suggestions as to how reporting could be simplified and improved with respect to these freelance stylists?

Questions for The Honorable J. Russell George, James R. McTigue, and Benjamin Herndon:

1. The most recent IRS study of the tax gap found the average <u>annual</u> tax gap for 2008-2010 is roughly $458 billion. Does the IRS, TIGTA or GAO have any data to confirm that the 45B credit has been successful in helping restaurant employers to encourage accurate tip reporting among their employees? Any data to show it hasn't helped?

2. The TIGTA report confirms that compliance has increased since implementation of tip agreements and that compliance is higher than would be achieved under regular examinations. How would voluntary use of TRAC agreements assist the IRS in compliance efforts?

3. A significant area of concern for salon owners is when their trained employees, who are subject to withholding, move to work as freelance stylists in non-employer salon establishments where they are required to report their business income themselves. Not only must they file estimated tax returns, but they must also file information reports regarding rental payments they make to landlords that are organized as unincorporated businesses.

a. We have heard from operators of chair rental establishments that they seldom, if ever, receive Forms 1099 from their chair renters. What does your data show regarding the level of compliance with information reporting requirements in the salon industry with respect to such rental payments?

b. There has been a substantial shift in the salon industry from employer-based salons to non-employer establishments, such as chair rentals and salon suites. What steps could be taken to improve compliance when such individuals who are subject to withholding and information reporting move to situations where there is neither?

4. What are the benefits to the IRS of changing the responsibility for filing the Form 1099, related to rental income, from the self-employed individuals to the landlord businesses who are more accustomed to complying with existing IRS information reporting requirements?

   a. How could the IRS utilize such information?

   b. To what extent could the IRS connect the rental payment expense deducted by such small business (as a cost of doing business) against the income generated by the individual in such business?

   c. Does information reporting of business expenses improve compliance by individuals?

   d. If the IRS receives a Form 1099 indicating a rental payment has been made, can it be assumed that the IRS has the capacity to compare it to a corresponding individual income tax return?

   e. To what extent does the existence of an information report increase taxpayer compliance, notwithstanding the fact the IRS may never completely utilize the information in its enforcement activities?

Questions for Benjamin Herndon:

1. TIGTA issued a report in September 2018 regarding tip-related tax noncompliance. The report relied extensively on data supplied by the IRS. For example, the IRS estimates that 10 percent ($23 billion) of the estimated 2006 individual income tax underreporting Tax Gap ($235 billion) is due to unreported tip income by employees.

   a. In the salon industry, not everyone who receives tips is an employee. To what extent does the $23 billion figure include free-lance workers?

b. Between 2005 and 2015, the number of salon establishments without payroll employees grew by more than 400,000. To what extent are these self-employment operations factored into your tip numbers?

c. Footnote 15 in the TIGTA report notes that the IRS does not have an individual unreported tip estimate for the reported TY 2008-2010.

   i. Why is your most recent data from 13 years ago?

   ii. Why wasn't unreported tip data included in the most recent tax gap study?

Dan Zattood